



# Commission on the 21<sup>ST</sup> Century Economy

## Members:

Gerald Parsky, Chair	Bill Hauck
Ruben Barrales	Jennifer Ito
Michael Boskin	Fred Keeley
John Cogan	Monica Lozano
Edward De La Rosa	Becky Morgan
Christopher Edley, Jr.	Richard Pomp
George Halvorson	Curt Pringle

## MEMORANDUM

Date: April 6, 2009  
To: Commissioner Becky Morgan  
From: Staff, Commission on the 21<sup>st</sup> Century Economy  
Re: Information Request

This memorandum is in response to questions and issues raised in your recent communication to staff. We have provided the following responses:

### I. Expenditure Reductions for County Offices of Education

Staff will discuss with the Chair how he wishes to proceed regarding this issue. In addition, since funding for the 58 County Offices of Education is a budgeting issue, it has been referred to the appropriate office at the Department of Finance.

### II. Effectiveness of the Research and Development Tax Credit

The Research and Development Tax Credit (RDC) was established in 1987, pursuant to Chapter 1138, Statutes of 1987 (AB 53, Klehs), and Chapter 1139, Statutes of 1987 (SB 572, Garamendi), and is generally tailored after a similar federal credit. The RDC has not been phased-out and has no sunset date.

The Legislative Analyst's Office (LAO) published a report (2003) on California's RDC. The LAO notes that economic theory suggests that without some form of subsidy, overall research and development in society would be lower than the economically optimal level. However, such a credit may be most effective and appropriate at the federal level and the LAO stated that a state credit is likely to be costly overall relative to the benefits provided through additional research activity. There is also very little research regarding the appropriate level of such a credit. The LAO recommended reducing California's research credit or phasing it out over time, in light of the substantial revenue losses associated with the program and the state's budgetary position. The report suggested that direct research-related spending; through the University of California for example, might be a more effective means of achieving the objective of stimulating research and development activity in the state.

The full LAO report is available at the following link:

[http://www.lao.ca.gov/2003/randd\\_credit/113003\\_research\\_development.pdf](http://www.lao.ca.gov/2003/randd_credit/113003_research_development.pdf)

### III. Funding from Proposition 172

Proposition 172, approved by the California voters in the 1993 statewide special election, established a permanent statewide half-cent sales tax for the support of local public safety activities.

Proposition 172 was placed on the ballot by the Legislature and the Governor to partially replace the \$2.6 billion in property taxes shifted from local agencies to local school districts as part of the 1993-94 state budget agreement. There has been debate around the underlying purpose of Proposition 172 and whether or not Proposition 172 funds were intended to supplement previous levels of local support for local public safety services.

Under Proposition 172, funds from the statewide half-cent sales tax are allocated to each county based on its relative share of statewide taxable sales. The countywide share is allocated to each of the cities within the county and the county itself, generally in proportion to its share of the property tax transfer.

Under Proposition 172 cities and counties must use their allocations from the half-cent sales tax to support public safety functions. Senate Bill 509 defines public safety functions to include police and sheriffs, fire protection, county district attorneys, ocean lifeguards, and county corrections. City and county court-related costs are specifically excluded from the definition of public safety. According to a policy brief (1994) by the LAO, the passage of Proposition 172 enabled counties to spend about \$700 million more for public safety in 1993-94 than they would have spent if the measure had failed.

The passage of Proposition 172 amended Article XIII Section 35 of the California Constitution to read:

SEC. 35. (a) The people of the State of California find and declare all of the following:

(1) Public safety services are critically important to the security and well-being of the State's citizens and to the growth and revitalization of the State's economic base.

(2) The protection of the public safety is the first responsibility of local government and local officials have an obligation to give priority to the provision of adequate public safety services.

(3) In order to assist local government in maintaining a sufficient level of public safety services, the proceeds of the tax enacted pursuant to this section shall be designated exclusively for public safety.

(b) In addition to any sales and use taxes imposed by the Legislature, the following sales and use taxes are hereby imposed:

(1) For the privilege of selling tangible personal property at retail, a tax is hereby imposed upon all retailers at the rate of  $\frac{1}{2}$  percent of the gross receipts of any retailer from the sale of all tangible personal property sold at retail in this State on and after January 1, 1994.

(2) An excise tax is hereby imposed on the storage, use, or other consumption in this State of tangible personal property purchased from any retailer on and after January 1, 1994, for storage, use, or other consumption in this State at the rate of  $\frac{1}{2}$  percent of the sales price of the property.

(c) The Sales and Use Tax Law, including any amendments made thereto on or after the effective date of this section, shall be applicable to the taxes imposed by subdivision (b).

(d) (1) All revenues, less refunds, derived from the taxes imposed pursuant to subdivision (b) shall be transferred to the Local Public Safety Fund for allocation by the Legislature, as prescribed by statute, to counties in which either of the following occurs:

(A) The board of supervisors, by a majority vote of its membership, requests an allocation from the Local Public Safety Fund in a manner prescribed by statute.



(B) A majority of the county's voters voting thereon approve the addition of this section.

(2) Moneys in the Local Public Safety Fund shall be allocated for use exclusively for public safety services of local agencies.

(e) Revenues derived from the taxes imposed pursuant to subdivision (b) shall not be considered proceeds of taxes for purposes of Article XIII B or State General Fund proceeds of taxes within the meaning of Article XVI.

(f) Except for the provisions of Section 34, this section shall supersede any other provisions of this Constitution that are in conflict with the provisions of this section, including, but not limited to, Section 9 of Article II.

In accordance with Article XIII, Section 35, revenues derived from Proposition 172 taxes are not considered proceeds of taxes for purposes of Article XIII B for government spending limits and are not considered State General Fund revenues. In this way the revenues from Proposition 172 are not included in the Budget Act as General Fund monies. A change to the way that Proposition 172 funds are accounted for would require a change to this section of the California Constitution.

The link to the LAO policy brief is provided below:

<http://www.lao.ca.gov/LAOApp/PubDetails.aspx?id=216>

#### **IV. Definition of a True Sale for Property Tax Purposes**

This topic will be addressed at the Commission's meeting on April 9<sup>th</sup> at UC Davis. In addition, Commission staff is preparing a memo on reassessment for changes in ownership and new construction under Proposition 13, as well as the significant exemptions for which a change in ownership or new construction does not trigger reassessment at fair market value.

#### **V. Federal Tax Law Conformity Bills**

California's last federal conformity bill was in 2002. One of the reasons the state has not had another conformity bill in recent years is because of the substantial cost. The issue was also raised by business representatives at the Commission's meeting at UCLA. Staff will discuss with the Chair how he wishes to address the issue of federal conformity.